STATEMENT BY THE DELEGATION OF THE FEDERAL REPUBLIC OF GERMANY

The German delegation has been asked to comment on the effects on prices and German foreign trade of the change-over from the cumulative turnover tax system to the value-added tax (TVA).

This matter has been treated very exhaustively within the Organisation for Economic Co-operation and Development. There the German delegation has exposed its views first in October 1967 before the introduction of the TVA. Its memorandum has been discussed in detail in a special ad hoc group. In the light of the experience of the first year after the change-over to the TVA the German delegation has made a detailed fact-finding report which has been treated in the Trade Committee of OECD and has been distributed as OECD document TC(69)9, first revision. We would have no objection if this report would be made available to this Working Party, if it wishes to get it.

The main points of the German fact-finding report on the effects of the change-over to the new tax system can be summarized as follows:

1. Effects on prices

When ascertaining the effects on prices under the aspect of the way how the TVA works, which has already been described in detail by the German delegation in Annex B of document Spec(69)49, two price movements were observed: it is the development of prices in the entrepreneurial sector on the one hand and that in the consumer sector on the other. In the entrepreneurial sector the TVA did not show any effects on costs and prices because of the right to deduct any taxes paid on preceding transaction stages. Therefore entrepreneurial prices which are best reflected by the industrial producer price index, have declined. This price index calculated on the basis of 1962 decreased from 104.7 in the last quarter of 1967 to 99.7 in the first quarter of 1968, i.e. by about 5 per cent. As expected, a tax cost burden of more than 1 per cent continued to rest on industrial products in 1968 owing to certain transitional regulations and to difficulties in the transition to the new system.

In the consumer price sector the TVA entered fully into prices. The price index of the cost of living of private households increased during the first six months of 1968 by 1.5 per cent over the level of the corresponding period of the preceding year. Of this price rise, over 1 percentage point was due to conversion difficulties to be overcome by the entrepreneurs when the TVA was introduced and the remaining part of the price rise was due to cyclical reasons.
When seeing both price movements together one could say that the reform of turnover taxation in the Federal Republic of Germany in 1968 has had those effects that had been expected from the TVA being an indirect tax. Prices dropped in those fields where the turnover tax had no more effects on costs and rose where the effects of the tax fully entered into prices, corresponding to the system of the tax. Therefore the conclusion may be drawn that the transition to the added value tax system in the Federal Republic of Germany was accompanied by the traditional price effects of indirect taxation, i.e. by price changes in accordance with the changes of tax burden on the goods.

2. Effects on foreign trade

Concerning the effects on German foreign trade of the turnover tax reform in 1968, the conclusion has frequently been drawn that the increase in the German trade surplus from DM 16.9 billion in 1967 to DM 18.4 billion in 1968 was directly connected with the transition to the TVA system. Mention has even been made of a devaluating effect of the change-over to the TVA. However, such a conclusion would be precipitated and has not been confirmed after a thorough analysis of the facts.

First it has to be stated that immediately upon the transition to the TVA on 1 January 1968, a tendency towards export promotion ceased to exist. This tendency was the result of the average border tax adjustment rates under the cumulative turnover tax system which favoured highly integrated companies and combines. Since statistical data relating to the actual cumulative turnover tax burden on large companies and combines are not available, it is difficult, however, to quantify this effect.

The tax costs arising during the transition phase for which no border tax adjustment measures were envisaged were estimated to 1 percentage point. Because of these costs it was expected that export prices of German industrial products would rise. However, this effect was not produced. Prices rather declined by 1 per cent from 1967 to 1968. The reason for this were factors outside the field of taxation. As a result of the productivity gains during the third quarter of 1967 until the first quarter of 1968 unit labour costs declined by 7.5 per cent in Germany. It is obvious that this reduction of unit labour costs has by far overcompensated the price rising effect of the tax reform on German exports. Moreover - due to several special influences - foreign demand expanded vigorously in 1968. Consequently an extraordinary rise of German exports was recorded. This shows that the export surplus in 1968 was due to other reasons than the tax reform. Also on the import side the reform had no devaluing effect. The price relation between imported and domestic products rather changed in favour of the imported products; before the introduction of the TVA the
ratio was 107.8 to 99.1 and thereafter 107.6 to 99.7 (1962 = 100). The high rate of increase of German imports after the tax reform - the rate of expansion came up to almost 16 per cent in 1968 as against 3.4 per cent in 1967 - reveals that the introduction of the TVA did not adversely effect foreign trade.

On balance the conclusion may be derived that the change from the cumulative turnover tax to the value-added tax has largely been neutral as regards its effect on German foreign trade. Therefore we are convinced that the concern the German tax reform could cause disturbances to the development of international trade was not justified.